

## In Search of Corruption Prevention Model: Case Study from Indonesia Village Fund

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**Abstract:** The purpose of this paper is to explore the causes of corruption in Indonesia village fund and to discuss the possible strategy to combat corruption. The research uses explanatory case study approach to get understanding through multiple types of data sources such as interviews, documents, publicly reports and news as well as government reports related to the corruption and village fund. Further, this study uses criminology theories to introduce a corruption prevention model. The results of the study describe various theories related to the causes of corruption from various approaches, such as criminology, psychology and social issues. The corruption prevention model produced in this study is the result of a combination of these theories that are adapted to various techniques that are often found in corruption in village funds. The corruption prevention model is expected to give a practical contribution as one of the references to curb corruption more efficiently.

**Keywords:** corruption; fraud triangle; fraud diamond; fraud pentagon; Indonesia village fund

**JEL Classification:** D73

### 1. Introduction

Village fund is one of the consequences of the issuance of Law No. 6/2014 (known as the Village Law) in Indonesia. The central government is required to allocate funding to each village. With approximately IDR 800 million to IDR 1 billion (50,365 – 62,957 Euro) to every village each year, they are given autonomy to determine the use of this funding. The funding allocation for the program has also increased over the years. The year 2015 was the moment when the funds were disbursed for the first time allocating IDR 20,7 trillion. The fund is surged and reached IDR 60 trillion in 2018. While there has been an enormous increase in village infrastructure due to the funding schemes, the progress generated through the

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program has not been without problems. There has been a stack of reports on the misallocation of funds and corruption done by the village officials.

A report from the Indonesia Corruption Watch (ICW) in 2018 revealed that village funds were one of the five sectors with the most corruption cases in 2017. Compared to other sectors, corruption in village funds was ranked first with 98 cases, far higher than the case corruption in the government with 55 cases, education with 53 cases, transportation with 52 cases and social community with 40 cases (ICW, 2018). Data from the Corruption Eradication Commission (*Komisi Pemberantasan Korupsi*-KPK) also show similar tendencies. According to the KPK report, in the first six months of 2017, a total of 459 community reports were received for alleged corruption of village funds (KPK, 2018). Not only it is immense in the number of cases, but the corruption of village funds also gives devastating nominal loss to the country. ICW report shows that the country's loss has increased over time. In 2015, the country loss was IDR 9,12 billion and rose dramatically to IDR 30,11 billion in 2017 (ICW, 2018).

The objects and modes of corruption of village funds are sundry. The village budget is one of the most common objects of corruption. Information from ICW shows that of 154 corruption cases, 82 per cent of the objects were village budgets, village funds, village treasury, and other budget-related. The remaining 18 per cent is corruption with village non-budget objects, such as illegal levies carried out by village officials. The modus of corruption of village funds were also divergent. Some of the popular techniques are by the practice of budget misuse, embezzlement, fictitious reports, fictitious projects/activities and budget markups (ICW, 2018).

Taken together, despite the continues national budget allocation for village fund, the corruption rates of the village fund also rising. Current efforts to prevent and detect corruption emphasise more on aspects of law enforcement so that resources are more focused on getting as many corruption perpetrators as possible in court. However, this approach is not sufficient to deter corruption. Individual behaviour and the surrounding situation, including the characteristics of villages that are very different from the city so far have not been highlighted as important variables for developing models for preventing and detecting corruption. The purpose of this paper is hence to explore the causes of corruption in the village fund and to discuss the possible strategy to combat corruption.

We present corruption prevention model which stemmed from these fraud theories. Arrogance, opportunity, pressure, rationalisation and competence were display as

the underpinning of corruption. These factors could be magnified with the contribution of individual characteristics, group dynamics and cultural and societal characteristics. There are three elements in the corruption prevention model, involving the stages of prevention actions, detections procedures and response controls. The technical details are also presented to each of the stages.

## 2. Scope and Methodology

The purpose of the research is to explore the causes of corruption in the village fund and to discuss the possible strategy to combat corruption. However, the definition of corruption across countries might be different due to different legal systems that is an activity considered legal in one country may constitute corruption in another (Syamsudin, Sriyana & Prabowo, 2012). In specific, this paper uses the Law no 20 the Year 2001 on the Eradication of Corruption as an amendment of the Law No 31 the Year 1999 to categorised corruption.

According to the law, seven activities could be classified as corruption:

1. Acts that cause losses to the nation;
2. Bribery;
3. Occupational embezzlement;
4. Extortion;
5. Deception;
6. Conflict of interest in the procurement of goods and service; and
7. Gratification.

Based on the classification, we limit our data finding and resources only if it fits the criteria. The research uses explanatory case study approach to get understanding through multiple types of data sources such as interviews, documents, publicly reports and news as well as government reports related to the corruption and village fund. The case study has been long used in social science research. It facilitates exploration of a phenomenon with a variety of lenses which allows for multiple facets of the phenomenon to be revealed and understood. The explanatory case study approach is suitable for the context of this study because it derived from the phenomena. Further, this study uses criminology theories to introduce a corruption prevention model. Criminology theories have been used widely by many researchers to understand why people commit crimes and delinquencies (Peltier-Rivest, 2018; Graycar & Sidebottom, 2012; Mandala & Freilich, 2017). In this study, the model is derived from criminology theories, namely, Fraud Triangle Theory, Fraud Diamond Theory and Crowe's Fraud Pentagon.

### 3. Corruption Cases in Indonesia Village Fund: Facts and Figures

According to the data from ICW (2018) and KPK (2018), a large number of corruption cases that fall upon to that seven categories and the amount of state losses was enormous. The number of corruption cases against village funds has increased from year to year, and the number of state losses that occur is getting bigger along the year. This is very alarming, considering the magnitude of the allocation of village funds sourced from the state budget every year is escalating. Table 1 below provides a summary of the number of cases and state losses caused by corruption in the village as well as the allocation of the national budget to the village.

**Table 1. Village Fund Corruption Cases Figures**

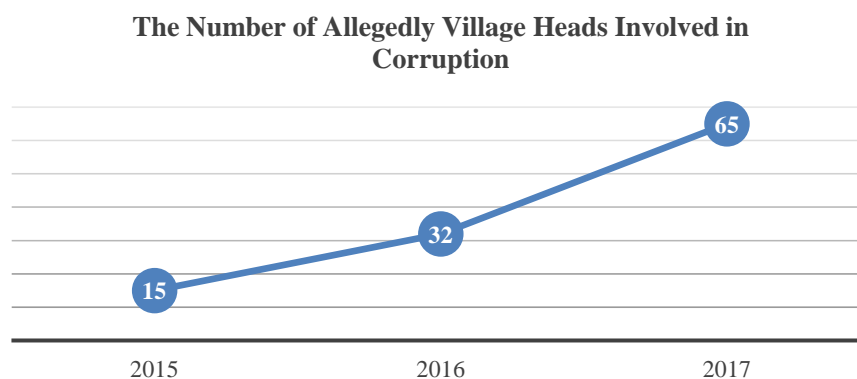
Year	Number of Cases	State Loss (IDR)	Village Fund Allocation (IDR)
2015	17	9,12 billion	20,8 trillion
2016	41	8,33 billion	47 trillion
2017	96	30,11 billion	58,2 trillion
2018	57	385 billion	60 trillion

*Source: owned representation based on Indonesia Corruption Watch, 2018; Corruption Eradication Commission, 2018; Ministry of Finance, 2018.*

Table 1 depicts the appalling fact regarding the corruption cases and how it affects the state loss. The more cases of corruption were found alongside with the surge of village fund allocation. In 2015, the year of the beginning of the program, there were seventeen cases. As the year goes by the number of cases were increasing, indicating the more village were involved in the misuse of the village fund.

Since the enactment of the Village Law in 2014, the allocation of village funds sourced from the National Budget began in 2015. In table 1, it can be seen that the allocation in the first year of the allocation of village funds amounted to IDR 20.7 trillion and surge more than doubled in 2015 with IDR 47 trillion and increase more in 2017 and 2018 with IDR 58,2 trillion and 60 trillion respectively.

The results of a study from ICW (2018) stated that as many as 15 corruption cases out of 17 cases that occurred in 2015 were carried out by the village head. The number of village heads involved in corruption cases is also increasing every year. In 2016 there were 32 village heads who were entangled in corruption cases and increased to 65 village heads in 2017. The ICW study (2018) also revealed that in addition to the village head, another actor who has the potential to commit corruption was the village treasury. These data show poor governance of village funds. Further, village heads and village officials, who are supposed to manage village fund for the merit and benefit of the community, are part of the practice of irregularities.



**Figure 1. The Number of Allegedly Village Heads Involved in Corruption**

*Source: Owned Representation based Indonesia Corruption Watch, 2018*

#### 4. The Technique for Corruption

The fact of involvement from the village government officials shows that the corruption happened to those who have access for the village fund. To further understand the technique being used to corrupt the village fund, we were studying news report as well as court decision to understand and find a pattern for corruption techniques. We conclude that there are five techniques in manipulating the village fund, namely budget misuse, embezzlement, fictitious report and projects and budget markups.

The budget misuse happens when it is accounted as the source of financing for village projects even though the project was initially sponsored by the other source. Village fund is one of many income sources for village government. As part of the income sources, the village fund is then accumulated with other sources of income in the village income and expenditure budget. For many corruption cases, the village fund is accounted for the financing of physical projects such as road construction even though the realisation is it was initially financed from other sources of village income. The other method for budget misuse was called the double budget, in which the perpetrators proposes a budget for a completed project.

The proper matching between the budget and its allocation is not in place yet. Therefore the village government officials see this as an opportunity to do fraud. The second technique is through the embezzlement. The perpetrators use the village fund either for their personal use or trimmed it then distribute it to their horde. Further, the village fund was also used by people to borrow money from but never returned it. Using village fund for personal use is simply a crime. The perpetrators whose

majority are village heads should have known that village fund is not for personal use nor village officials remuneration.

The third and fourth technique is related to the fictitious projects and reports, which was carried out by proposing an operational budget for a non-existing project. The perpetrators use fictitious projects to disburse the village funds and create fictitious reports as their responsibility statements. This technique of village fund fraud is rather complicated than other techniques since it required effort and understanding to create a proposal and report for non-existence projects. Last but not least is the budget markups. The perpetrators will mark up the market price of products and services stated on the budget as well on the report. Price inflating of products and services are not regulated due to distinct price, which is different according to each village.

## 5. Theoretical Development

To prevent corruption, every organisation must understand what underpinned corruption. In the context of this study, the underlying question is what encourage village government officials to become corrupt. Corruption is categorised as a facet of fraud, in unison with asset misappropriation and fraudulent financial statements. For more than two decades, scholars have attempted to explain and predict fraudulent behaviour that happens in many setting of the organisation.

### 5.1. Fraud Triangle Theory

One of the groundbreaking studies in criminology fructifies the development of the fraud theory is the Fraud Triangle Theory (Cressey, 1973), which has been cited extensively by many academicians. According to this theory, three factors that significantly influence the emergence of corruption are opportunity, financial pressure and rationalisation.

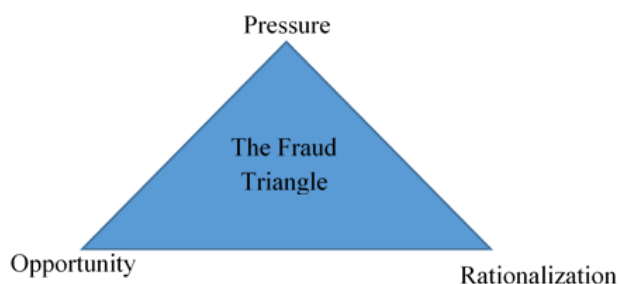
*Opportunity* refers to the perceived ability to commit fraud. Opportunities to commit fraud happens when perpetrators aware of the weakness of an organisation's system. Nevertheless, it can also arise when supervision is absent or because of the abuse of power. The perpetrator who happens to be the employee is more likely to understand their organisation shortcomings and understand how to deceive the system. In the context of this study, the village officials perceive that they have an opportunity to engage in corruption without being caught. Further, the perceived opportunities are generated when the perpetrators have the knowledge related to the weakness of an organisation's system and the technical skills to commit fraud. According to the Fraud Triangle Theory, the opportunity to commit fraud can be minimised through a proper process, control and the existence of a fraud detection system.

*Financial pressure* is the second component in the Fraud Triangle Theory, which could be in the form of perceived financial problems or motives that drives a person to commit fraud. Financial pressure does not necessarily happen to poor people. The word perceived indicates that the financial problem does not have to be real. Luxurious lifestyles, debt problems and drug abuse addiction might be the source of perceived financial pressure on this matter. As explained by Cressey (1973), people commit fraud when they believe that they have such a problem. Therefore, we could often found the corruptors are rich and considered as respected figures.

*The rationalisation* is related to the justification made by the perpetrators to validate their action. As being concluded by Cressey (1973), many fraudsters are first-time offenders with no criminal record. They see themselves as good people who trapped in bad situations, and this enables them to justify their criminal actions. In the context of this study, the village head could have sought justification for his corrupt actions because he felt he had contributed a lot to the development of his village. Hence, taking a per cent of the village fund is legitimate and harmless. The three elements of fraud developed by Cressey (1973) are presented in a diagram shown in Figure 2.

## 5.2 Fraud Diamond Theory

One of the significant works followed by the Fraud Triangle is the Fraud Diamond. In 2004, Wolfe and Hermanson argued that capability could be added as the fourth element in the fraud triangle theory. Wolfe and Hermanson (2004) considered an individual's capability to play a major role in whether fraud may occur. Capability in which refers to the individual's competence and traits is suggested to be significant since many frauds, especially those involving a large amount of money, would not have occurred without perpetrator having competence and capabilities.



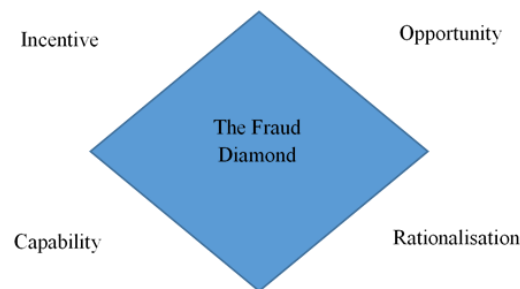
**Figure 2. Fraud Triangle Theory**

*Source: Wells (2005)*

In their work, Wolfe and Hermanson (2004) described that the opportunity opens the door for the perpetrators to commit fraud, and financial pressure, as well as rationalisation, make them closer to the door. However, without the ability, the

perpetrators would not be able to recognise the opportunity to see and walk through the door and commit fraud and find a way to conceal it. In other words, the capability gives the perpetrator a chance to turn desire into reality.

Further, Wolfe and Hermanson (2004) identified observable traits of personal competence in commit fraud. Those traits include (a) functional authority within the organisation, for example, a village head might have the ability to perpetrate fraud due to his or her position within an organisation; (b) sufficient intelligence to understand and exploit the situation, including the organisation's system; (c) confidence that the fraudulent actions would not be detected, as a consequence the greater the confidence, the greater chance for the perpetrators to commit fraud; (d) ability to coerce others to commit or conceal the fraud, a fraudster with persuasive personality might be able to convince others to commit fraud or to simply look the other way; (e) effective deceptiveness, a fraudster to avoid detection must have the ability to lie consistently and convincingly; (f) ability to deal well with stress since dealing with fraud over a long period of time could be stressful as fraudster should have a high tolerance with a high dose of stress to conceal and manage their fraudulent act.



**Figure 3. The Fraud Diamond**

*Source: Adapted from Wolfe and Hermanson (2004)*

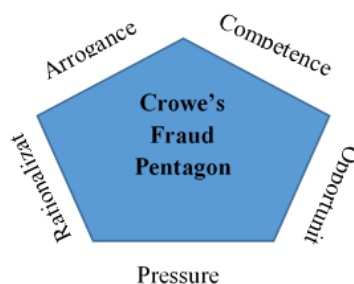
#### 4.3. Fraud Pentagon

Crowe Horwatt presented an updated theory of fraud in 2011 known as Crowe's Fraud Pentagon. But it was Jonathan T. Marks who, a partner at Crowe Horwatt, that argue there are two more elements of fraud, namely competence and arrogance. The competence element has the same meaning as a capability in which previously explained in the fraud diamond theory. It refers to the competence or capability to ignore internal control, develop a strategy to conceal the fraudulent acts and control the social situation for his or her own benefit. Meanwhile, arrogance refers to the superiority attitude about having special rights and the thought that an organisation's internal control does not apply to them personally.

Research by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) found that 70 per cent of the fraud perpetrators have a profile



featuring a combination of pressure with arrogance and greed (Horwart, 2011) Further, big egos, bullying attitude, autocratic management style and fear of losing position or status magnified the tendencies of someone to commit fraud. The five elements in Fraud Pentagon depict in Figure 4, pressure, opportunity, rationalisation, competence and arrogance, can provoke an individual to fraudulent behaviour.



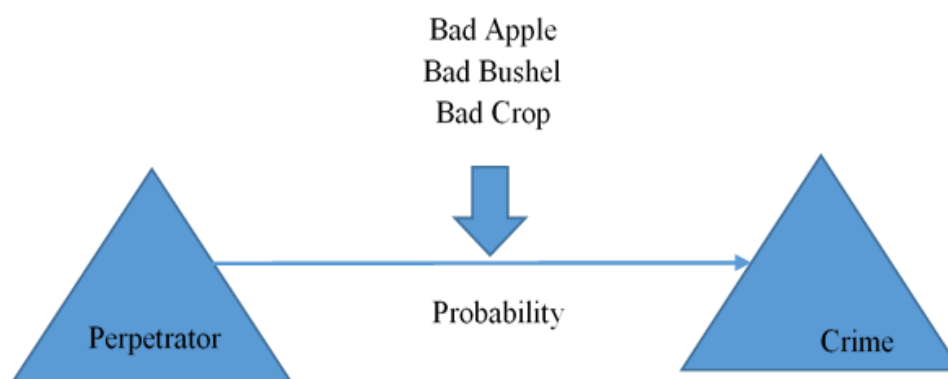
**Figure 4. Crowe's Fraud Pentagon**

*Source: Horwart (2011)*

#### 4.4. A-B-C Fraud Model

The aforementioned theories and research have been modified the elements of Fraud Triangle. A-B-C of Fraud Model, on the other hand, propose an analysis and categorisation of fraud that expanded the antecedent condition of fraud. Ramamoorti et al., (2009) use the psychological and sociological approach to re-engineering the fraud model. Ramamoorti et al., (2009) proposed that three antecedent conditions will result in fraudulent behaviour: a bad Apple, a bad Bushel, and a bad Crop. The bad apple refers to the individual personality characteristics of those that commit fraud, the bad bushel addresses to the group dynamics of collusive behaviour and the bad crop refers to a cultural and societal mechanism that enhances or permit the likelihood of fraud.

According to Dorminey et al., (2012), the A-B-C Fraud Model impact the fraud probability vector. Further, they argue that one of the significant contribution of Ramamoorti et al. (2009) work is the introduction of the concept of a bad crop. Dorminey et al., (2012) argue that once an illegal practice was done by a particular organisation becomes popular and trendy, it may create pressure on other similar organisations to consider doing the same. They refer to this situation as fraud epidemics in which they believed is consistent with the concept of a bad crop.



**Figure 5. The impact of A-B-C Fraud Model on the Fraud Triangle**

*Source: Dorminey et al., 2012*

## 5. Corruption Prevention Model

To fight for corruption effectively requires a comprehensive corruption management framework, covering the full-cycle of anti-corruption activities. In the context of this study, the corruption prevention model is aimed to prevent corruption in Indonesia village fund. The government of Indonesia acknowledged the vulnerability of the village fund to be abused. Village Fund Task Force (or known as *Satgas Dana Desa*) was created to oversee the implementation of village fund as well as formulating related policies and accepting and following up report regarding alleged irregularities of village fund. However, according to ICW (2018), the Task Force does nothing significant in the face of the corruption of the village fund.

The corruption prevention model that we propose in this study stems from the A-B-C Fraud Model and Fraud Pentagon Theory. The perpetrator has elements which are explained on the Fraud Pentagon theory – arrogance, competence, opportunity, pressure and rationalisation. These elements can be predisposed by the individual characteristic, group dynamic within the organisation and cultural as well as societal characteristic in which the perpetrator lives. These three factors enhance the likelihood of corruption to occur. To combat corruption, the corruption prevention model proposed in this study comprises three main components, preventive action, detection procedures and response control.

Preventive action refers to the creation of internal sound control and ethical work environment. It also indicates the point to the development of a work environment where corruption is less likely to occur. It is designed to help reduce the risk of corruption from occurring in the first place. Detection procedures are used to uncover the crime, in which it includes an effort to create safe whistleblowing system and integrity at the workplace. Response control refers to the corrective action and

remedies the detriment caused by corruption. The proposed corruption prevention model is presented in Figure 6.

### **5.1. Preventive Actions**

#### ***Effective Internal Control Procedure***

The Committee of Sponsoring Organization of the Treadway Commission (COSO) defines internal control as a process effected by the people which is designed to provide reasonable assurance in order to achieve an organisation's objectives. In a broad concept, internal control involves everything that controls risks to an organisation. In accordance to the technique of corruption of village fund which is commonly found, such as fictitious projects and reports as well as embezzlement, internal control procedures should involve physical audits of village projects and standardised financial report and financial system.

Physical audits include field monitoring to check the progress and compatibility of the village projects. Physical audits should be monitored by the authorities who are responsible to monitored the use of village fund. It can be done periodically during the time of the projects. The physical audit can be done in the procurement of goods and services such as building roads, hospital or other public facilities. The audit should be done thoroughly not only to check the construction progress of the roads, building or other public facilities projects but also to check the compliance and conformity of the projects to the budget used.

Standardised financial report and financial system can help maintain the consistency in reporting and recording. Using a standardised report could also make it easier to review past records when searching for the source of discrepancy in the financial report or system. This standardisation should also encompass periodic check by the authorities to make sure the village fund is used appropriately.

#### ***Corruption Risk Management Programs***

As part of preventive actions, a corruption risk management program should be initiated to identify any potential corruption before it occurred. Corruption, risk management program, should be planned and invoked as needed across the cycle of village fund outlay. The corruption risk management program for village fund should be developed to help the authorities to understand the risk of village fund management, identify weakness in control to mitigate those risks and develop a practical plan to reduce the risks.

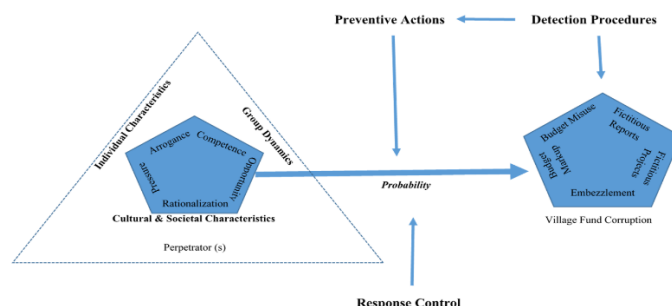
The village fund management cycle consists of planning, budgeting, action, administration, reporting and yearly accountability report (Figure 7). Throughout this cycle, the authorities should be able to identify the potential corruption risks on suspicious activities, projects or reports. After corruption risks identification, the authorities could develop risks rate in which based on the likelihood and significance

of occurrence. Last but not least is to create remedy risks through control optimisation. This corruption risk management programs should be implemented throughout the village fund management cycle. For continuous improvement, corruption risk management programs should also be evaluated periodically as the modes and techniques of corruption might also change over time.

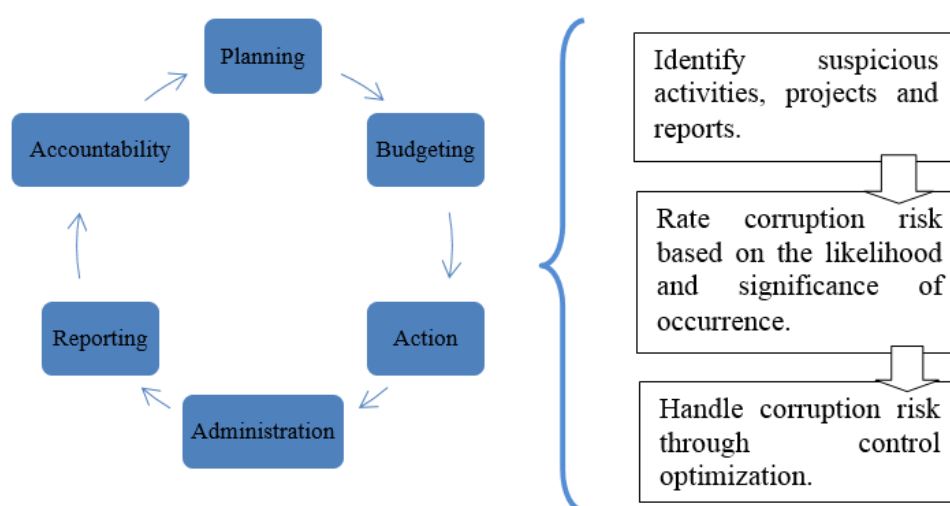
### ***Setting an Ethical Culture***

One of the prominent factors to attack rationalisation element explained in Fraud theories is to create a work environment where ethical sensitivity causes an individual to have second thoughts to commit fraud (Dorminey et al., 2012). Setting an ethical culture in the village governance is very important as it can promote ethical behaviour among village officials. To create an ethical culture, Robbins and Judge (2013) suggest that five things need to be applied. First is to set a role model, meaning that those in a position of authority should be able to display ethical behaviour as the example for their subordinates. When the top is observed to be ethical, it will send a positive message for all subordinates. This is in line with the research done by Sutherland, Cressey and Luckenbill (1992) in which they argue that dishonest employees would infect a portion of honest ones and conversely, honest employees might also influence those who are dishonest.

The second is to communicate ethical expectations, in which it can be done through the dissemination of the organisational code of ethics and what is expected to follow by the member of an organisation. The code of ethics should not be treated as the wall decoration in the village office. However, to create effective communication, the head villages should be able to perform ethical behaviour. Otherwise, it will be worthless. The third point is to offer ethics training. A study by Kaptein (2014) shows that organisations that have an ethics program have less occurrence of unethical behaviour. Ethics training can be used to reinforce the organisation's code of ethics, to give an understanding of what practices are and are not permissible as well as to address possible ethical dilemmas. The fourth point is the reward and punishment mechanism in which the performance indicators should include an evaluation of whether the decision made by the village government is complying or up against the law. A village head or officials who perform ethically should be visibly rewarded, and those who violate the ethics should be punished accordingly. Dorminey et al. (2012) argue that the fear of punishment is one of the primary deterrents for misconduct behaviour. Finally, the fifth point is to provide a protective mechanism in which the village officials or related parties can discuss ethical dilemmas and report corruption without fear of reprimand.



**Figure 6. The Corruption Prevention Model**



**Figure 7. Framework for Corruption Risk Management Program**

## 5.2. Detection Procedures

### *The mechanism for Reporting Misconduct and Seeking Advice*

An organisation needs to make its employees feel comfortable to share their concern related to the clarity of certain acts and to report improper conduct. A hotline could provide a viable method where the village heads or officials and public, in general, are encouraged to seek advice before making a decision regarding the unclear situations or problems and to communicate concern about potential corruption in the use of village fund.

To create such objectives, a well-designed hotline should include the features of anonymity and confidentiality that allows the anonymous submissions and resolutions help. The anonymity and confidentiality are also important to make sure that the informant will not experience retaliation from their co-workers. Following

up the report of misconduct or alleged corruption should also be taken in place. The reporting mechanism should be able to monitor the report that is being conveyed to the higher authorities.

### ***Auditing and Monitoring***

Auditing and monitoring are important tools that can be used by the authorities to determine whether or not the village government as an organisation has a control that works as intended. The authorities should develop a comprehensive auditing and monitoring plan that is based upon the corruption risk, which has been identified in the risk management program. Auditing on the village level can be done by government internal auditor assigned by the central government', while internal village government officials should perform the monitoring activities because it involves real-time evaluation.

### **5.3. Response Control**

#### ***Investigations***

Investigations can play a major role in taking corrective action to the corruption or other misconduct behaviours. The purpose of an investigation should be to gather facts of the suspected violations and help authorities to decide a sound course of action. Investigations should not only emphasise on the search of the perpetrators but also motives and techniques of doing crimes. A well investigative process should provide government officials, authorities, regulators and where appropriate, the public, relevant information regarding investigation findings. This course of action is to make sure the spirit of transparency and proper disclosure is accountable.

#### ***Law Enforcement***

Vigorous law enforcement will send the signal to the public in general that the corrective actions are done. It also sends a signal both for internal and external stakeholders that managing corruption risks is a top priority. To create firm law enforcement, the authorities can promote progressive sanctions which reflect the magnitude of the offence. For example, the verbal warning as early reprimand then continues with a written warning to suspension for a more serious note. Salary reduction to termination of work contract could also be applied as alternative enforcement.

## 6. Conclusion

The allocation of a village fund is increasing over time. However, the significant number of corruption cases is escalating in parallel. Various facets of village fund corruption techniques are found, and its underpinnings are being discussed in this study. In this light, the link between the two of them is discussed in this study through a proposed corruption prevention model.

Fraud Triangle Theory as the early work on the fraud theories has been expanded and enhanced as outlined in this study. The continuous discussion and exploration of the causes of corruption are important to develop a sound corruption prevention model. We present corruption prevention model which stemmed from these fraud theories. Arrogance, opportunity, pressure, rationalisation and competence were display as the underpinning of corruption. These factors could be magnified with the contribution of individual characteristics, group dynamics and cultural and societal characteristics.

To deter corruption, we identified three elements in the corruption prevention model, involving the stages of prevention actions, detections procedures and response controls. The technical details are also presented to each of the stages. Using the corruption prevention model proposed in this study, future research could delve into unexplored areas such as the interactions among construct presented in the model, moderation effect of preventive actions, detections procedures or response controls to the likely occurrence of corruption and better tools to improve preventive corruption.

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